FINANCIAL
AND FISCAL
COMMISSION

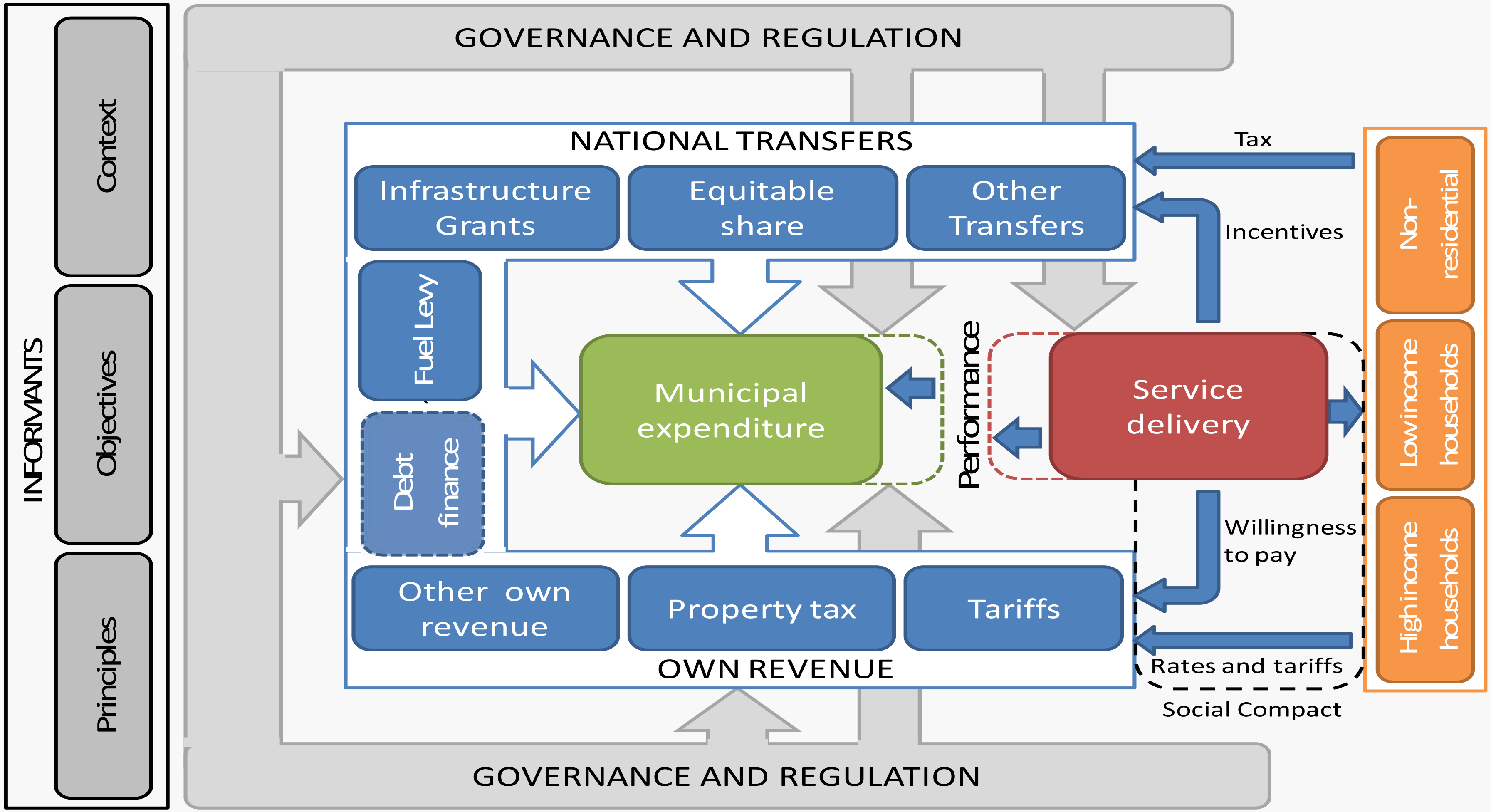
Fiscal Frameworks and Reforms within a Municipal Environment

Municipal CFO Forum

The Dunes Resort, Plettenberg Bay

10 December 2014

Local Government Fiscal Framework (LGFF) Environment



Contextualising the LGFF

- LGFF structure is complex and multi-dimensional
- Aim of the LGFF is to ensure adequate service delivery to communities through appropriate funding of municipalities
- Recipients of municipal services are **non-residential** (private sector, non-governmental organisations etc.) and **low-income** and **high-income households**
- Service delivery to communities is achieved with **municipal expenditure supported by various revenue streams**
- Nexus between service delivery, consumers and municipal own revenues takes the form of the principle of a **social contract**,
- A comprehensive system of **governance and regulation** informs the operation of the LGF

FINANCIAL AND FISCAL COMMISSION

Key Outcomes of FFC Review of LGFF

- Key themes raised in FFC review of the LGFF:
  1. The need for LGFF to be based on a differentiated approach
  2. Local government equitable share: need to review the horizontal and vertical division of revenue
  3. There is a vertical fiscal gap driven by huge capital expenditure and rehabilitation/backlogs needs
  4. Municipal revenue capacity
  5. Review of conditional grants framework

FINANCIAL AND FISCAL COMMISSION

1. Differentiation

- The LGFF must account for:
  - Variation in municipal context (exogenous factors): poverty; economic activity within a municipality, spatial factors such as topography and population density; powers and functions assigned; population dynamics (migration)
  - Variation in municipal performance (endogenous factors): debt collection, expenditure efficiency, vacancy rates; ability to plan and execute budgets
- Aspects of differentiation evident in the financing system (for example specific programmes aimed at cities/urban relative to rural municipalities), but this needs to be strengthened
- System should be driven by appropriate incentives

FINANCIAL AND FISCAL COMMISSION

2. Local Government Equitable Share Allocation

- The local government equitable share (LGES) allocation receives the smallest proportion of nationally raised revenue in the vertical division of revenue but the proportion has been growing year on year relative to national and provincial spheres
- Vertical division of revenue is critical in light of declining local government fiscal capacity (particularly given abolishment of RSC levies) – issue remains outstanding
- With respect to horizontal division of revenue, the Commission welcomes the revisions made to the LGES formula and implemented in 2013. The revised formula sees a greater distribution of funds to poorly resourced municipalities
  - An outstanding issue relates to the costing of basic services to inform the LGES allocation. The FFC and Salga are undertaking work on this aspect

FINANCIAL AND FISCAL COMMISSION

3. Capital Expenditure and Rehabilitation Needs

- Municipal capital investments are pivotal for supporting local economic growth and extending basic services to poor households
- Commission public hearings on the LGFF confirmed a vertical capital funding gap. Current infrastructure grants are not sufficient to cover capital expenditure needs given current funding sources
  - Given constraints on own revenue capital funding sources – is the gap widening?
    - Capital funding sources are progressively under pressure
    - Own revenue surpluses diminishing
    - Rating downgrades for metros due to downgrade of sovereign state
- Capex gap filling should be closely related to capacity improvement to avoid underspending and improve absorptive capacity
  - Internal controls improved, act on Auditor-General's findings
- Greater support for local government from other spheres as per Section 154
  - Improved monitoring and evaluation and capacity support

FINANCIAL AND FISCAL COMMISSION

4. Municipal Revenue

- An ideal LGFF should promote greater revenue instruments to municipalities where there is a relatively strong tax base such that transfers can distribute more funds to municipalities where the tax base is constrained
- Fiscal capacity has declined over time. In 2004/5, aggregate municipal own revenues amounted to 90% of aggregate expenditure. In 2014, this has declined to about 75% of aggregate municipal expenditure
  - The Commission is concerned with both urban and rural municipalities progressively becoming more dependent on grants
    - Greater macroeconomic constraints (external factors)
    - Increasing municipal consumer debt levels (internal inefficiencies)
- One of the main drivers behind the decline in own revenue capacity and concomitant increase in grant dependence was abolition of RSC Levy
  - To date an appropriate own revenue instrument to replace the RSC Levy has not yet been found for district municipalities

FINANCIAL AND FISCAL COMMISSION

5. Review of Conditional Grant Frameworks

- Key concerns related to infrastructure conditional grants:
  - Recurrent under-spending, proliferation, perverse incentives, and whether they reflect priorities of the National Development Plan or government policy in general
  - In this regard, FFC welcomes ongoing review of infrastructure grants by Government that commenced towards end of 2013 – FFC is a member of the review team
    - Issue of incentive/performance based grants is critical – positive and negative incentives can assist with improving performance
- Specific issue of indirect grants (where a national sector department performs a function on behalf of a municipality or province) being further explored by FFC
  - Whilst this practice can be good if it ensures infrastructure delivery in cases where there is a lack of municipal capacity, there are risks involved
    - Compromising accountability
    - Difficulties planning and budgeting for maintenance of infrastructure
    - Possibility of imposing irrelevant technologies

FINANCIAL AND FISCAL COMMISSION

Towards Solving Challenges Confronting LGFF?

- Collaborative work by various task teams are underway and may come with up innovative solutions that serve to alleviate some of the challenges confronting the LGFF. These include:
  - Ongoing review of LGES formula (National Treasury, FFC, Salga, Statssa)
  - Ongoing review of local government infrastructure grants (National Treasury, FFC, DCoG)
  - Review of metropolitan own sources of revenue (National Treasury, Salga, representatives from metros)
  - Review of local government functional and fiscal framework (led by DCoG and which is key in addressing issue of unfunded mandates)
  - Review of indirect grants (FFC)

FINANCIAL AND FISCAL COMMISSION

THANK YOU.

Financial and Fiscal Commission
Montrose Place (2nd Floor), Bekker Street,
Waterfall Park, Vorna Valley, Midrand,
Private Bag X69, Halfway House 1685
www.ffc.co.za
Tel: +27 11 207 2300
Fax: +27 86 589 1038